

Statement of
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and
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before the

National Security and Veterans
Task Force

of the

Committee on the Budget
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Mr. Chairman, Mr. Slackman and I appreciate the opportunity to testify on military manpower issues before your Task Force. In fiscal year 1982, the Department of Defense will spend about \$70 billion, or about one-third of all its outlays, on military manpower. These dollars will pay for the salaries, benefits, training, and support of some three million military personnel. Thus, military manpower issues are a key component of defense spending.

In addition, difficulties in recruiting and retaining military personnel--particularly personnel on active military duty--have brought manpower issues to the fore in recent years. Our testimony today will address these areas of costs, recruiting, and retention. We will focus on enlisted personnel on active duty, since they involve the largest part of costs and present the most difficult problems.

The sections that follow suggest three major findings about costs, recruiting, and retention:

- o First, the pay raises enacted last year, if maintained in future years, should increase the size of each service's career force. On the other hand, some services--particularly the Army--may still have problems recruiting enough high-quality enlisted personnel.
- o Second, the new Administration's proposed additions to military pay, principally the 5.3 percent pay raise

effective this July, should further improve career retention and should allow the Army to come close to meeting its recruiting goals in 1982.

- o Third, the Congress might wish to try to hold down costs by using across-the-board pay raises to keep pace with the private sector but targeting special increases on occupations with the most acute recruiting and retention problems. Some further restructuring of the military retirement system might also be considered.

As these findings suggest, our testimony today will focus on compensation issues. This is not to suggest that other factors--including personnel policies, national pride in the military, and servicemen's morale--are not critical to recruiting and retention. The Congress, however, has the most direct control over military compensation. Also, compensation issues directly influence the cost of manpower, which is a major focus of analysis at the Congressional Budget Office.

The following sections discuss each of the three major findings in more detail.

RECENT PAY INCREASES SHOULD IMPROVE RECRUITING AND RETENTION

Summary of Changes

As background for considering the Administration's pay raise proposals, we would first like to assess the probable effects

of the military compensation increases enacted by the 96th Congress. These included an 11.7 percent pay increase for all military personnel, a substantial new variable housing allowance aimed at areas with relatively high housing costs, higher pay for sea-going and aviation personnel, and numerous other increases in pay and bonuses. Together, these increases added about \$2.3 billion to the pay costs requested in the original version of the fiscal year 1981 budget. Many of the pay increases were targeted at career personnel.

Effects on Retention

CBO estimates that these pay increases, if maintained in future years by granting pay raises that keep pace with those in the private sector, will increase numbers of careerists. (Careerists are defined as those personnel with more than four years of military service.) Total numbers of enlisted careerists should rise from about 745,000 at the end of fiscal year 1980 to about 866,000 by the end of 1986. Given these increases, by the end of 1982 every service--except the Navy--would meet the career objectives it established last year. The Navy would meet its objectives by 1984. (These estimates are substantially higher than CBO estimates published several months ago because of new data on the numbers of persons returning to the military after prior military experience.)

These improvements in retention are not just forecasts; they have already begun. Reenlistment rates are up, and several services have asked for increases in their budgets to reflect improved retention. The services could, of course, hold down the increases in careerists by imposition of more stringent reenlistment standards. Or they could revise their careerist objectives upwards to reflect higher end strengths and the retention improvements.

These retention estimates assume that the Congress enacts future pay increases that keep pace with increases in the private sector and so maintain the real level of pay established this year. For fiscal year 1982, CBO estimates that a pay raise of between 9 and 10 percent would maintain current pay levels. Raises required in years beyond 1982 would depend on prevailing economic conditions.

These projections refer to all enlisted careerists, regardless of skill area. Some services may have shortages in specific skills, particularly highly technical skills.

Furthermore, while increasing total numbers of careerists, retention improvements would not rapidly reverse trends toward a more "junior" career force. Large numbers of retirements in recent years have increased the proportion of junior careerists (with 5 to 12 years of service) compared to numbers of senior careerists (with over 12 years of service). This trend has been of particular concern in the Navy and Air Force.

Effects on Recruiting

The recruiting problem involves more than meeting the services' numerical recruiting goals. Not only must these numerical targets be met, but the services must be able to attract sufficient numbers of recruits who meet high enlistment standards. These standards are typically defined by the percentage of non-prior-service male recruits who hold high school degrees and score high on an aptitude test given to all new recruits. (Enlistment standards focus on male recruits, since they make up the largest part of the armed services and are the most difficult to recruit.)

Improvements in career retention will help meet recruit needs and quality goals by reducing the demand for new recruits. But at the same time, the more stringent quality standards enacted by the Congress will complicate the services' recruiting problems. Last year, the Congress set limits on the percentage of recruits the services can accept from the lowest acceptable test-score category, referred to as Category IV. Under current law, no more than 25 percent of all recruits entering each service in 1982 can score in test-score Category IV; that limit tightens to 20 percent in 1983 and beyond. Yet in 1980 the Army--which has the most difficult recruiting problem--took 52 percent of its recruits from Category IV. In addition to the test-score objectives, the Congress also required that 65 percent of all Army male, non-prior

service recruits in 1981 hold high school degrees; that requirement could well be extended to future years.

To date, fiscal year 1981 has been an excellent recruiting year. This has occurred in part because the test-score constraints just described are less restrictive this year than in 1982 and beyond. But CBO estimates that, in 1982 and beyond, the services--particularly the Army--will have difficulty achieving their numerical goals while also meeting quality standards. This will be true even if the pay increases enacted for fiscal year 1981 are maintained in future years. In particular, if the Army meets the test-score constraints, then only about 60 percent of its male recruits are likely to hold high school degrees in 1982. This would be similar to the Army's success in 1978 to 1980, but would fall below the 65 percent goal set for 1981 and below results in many years of the 1960s and early 1970s, when the draft was in effect.

Moreover, by 1986 the percentage of Army recruits holding high school degrees would decline to about 53 percent, which is well below the recent average. Other services might also have difficulty meeting the quality standards in the years beyond 1982. The decline in percentages of high school graduate recruits over the next five years will result not only from the tightening of test-score goals but also from the projected decline of the youth population.

Despite the important effects of quality goals on enlisted recruiting, we know relatively little about the desirable mix of recruits with high school degrees and those with varying test scores. We do know that recruits holding high school degrees are about twice as likely as nongraduates to complete their first term of service, regardless of their test scores. There is also some evidence that recruits in the higher test-score categories do better on Skill Qualification Tests, which measure basic military job performance. But the Department of Defense has little information for determining the ideal mix of recruits. Perhaps for this reason, the Acting Assistant Secretary of Defense for Manpower, Reserve Affairs, and Logistics asked in recent testimony that the Congress lift the test-score constraints. Nonetheless, concerns over recruit quality may well prompt the Congress to leave the quality constraints in place, at least in some form.

With these assessments in mind, we turn to the new Administration's proposals.

ADMINISTRATION PAY PROPOSALS LIKELY TO PRODUCE FURTHER IMPROVEMENTS IN RECRUITING AND RETENTION

Summary of Changes

In addition to the 11.7 percent pay raise already enacted for fiscal year 1981, the Reagan Administration has called for a 5.3 percent across-the-board military pay raise, effective in July of this year. The regular pay raise next October would be

9.1 percent. The Administration estimates that the added 5.3 percent raise would cost \$420 million in 1981 and \$1.9 billion in 1982. In addition, it has proposed other increases in compensation that would raise costs by about \$200 million in 1982, as well as improvements in housing and other indirect benefits costing an additional \$140 million. Finally, the Administration would add \$150 million to a contingency fund for new compensation legislation, bringing the total in that fund to \$370 million.

Military manpower levels would also increase under the Administration's proposal. The total size of the military would reach 2,120,000 by the end of fiscal year 1982--70,000 above the 1980 force level and 26,000 higher than the level proposed by the Carter Administration for 1982.

Effects on Recruiting and Retention

Our preliminary estimates suggest that the Administration's pay proposals would further enhance career retention. Numbers of careerists would reach 794,000 by the end of 1982, compared to 784,000 assuming continuation of pay increases already enacted. As for recruiting, the Army should be able to meet the test-score constraints set by the Congress while also recruiting about 64 percent high school graduates, which is very close to the target of 65 percent set by the Congress for 1981.

Projections beyond 1982 depend on policies that have not yet been spelled out. But, assuming some further increases in personnel strengths plus enactment and maintenance of the requested pay increases, retention should continue to improve. By 1986, total numbers of careerists should equal 914,000, compared to 866,000 assuming maintenance of today's pay levels. On the other hand, recruiting would still show a decline. By 1986, the percentage of Army recruits holding high school degrees would equal 58 percent. This is higher than the 53 percent level assuming maintenance of today's pay levels, but still well below averages in the 1960s and early 1970s.

Indeed, the percentages holding high school degrees could be substantially lower than these estimates. The 53 percent estimate assumes that overall unemployment by 1986 remains at about 7.0 percent; this is a CBO baseline projection assuming some tax cuts but no spending cuts. The Administration has forecast a 5.6 percent unemployment rate in 1986. Lower unemployment tightens the enlisted recruiting market substantially and so cuts recruiting success.

Having discussed the Administration's proposals, we would like to turn now to some alternatives for meeting recruiting and retention goals. These could be considered by the Congress and the Administration both in 1982 and in the years beyond.

ALTERNATIVE METHODS TO IMPROVE RECRUITING AND RETENTION

More Use of Bonuses, Special Pays, and Targeted Pay Raises

The Administration has proposed substantial increases in military pay that should make important improvements in recruiting and retention. Most of the increase comes from the special, across-the-board pay raise of 5.3 percent effective this July.

Yet recruiting and retention problems do not affect all categories of military personnel. Recruiting problems center on attracting high-quality youth into specialties like combat arms. Such military professions are rigorous and difficult but offer relatively little training that is useful in the private sector. There are fewer problems attracting youth into specialties requiring highly technical skills or into the officer corps (with the exception of attracting engineering, medical, and nuclear officers). Retention problems, not surprisingly, occur most often in the technical skills. After receiving training in technical areas, enlisted personnel are highly employable in the private sector. Retention problems also center on more junior careerists, since military retirement is a powerful retention incentive for senior careerists.

Given the specific nature of these problems, the Congress could consider using across-the-board pay raises only to maintain overall pay levels. Additional increases in pays could be targeted on those occupations that have experienced the most

acute recruiting and retention problems. Thus, for example, the Congress could use some of the money that would be spent on the 5.3 percent pay raise to increase enlistment and reenlistment bonuses. Special pays could also be increased to meet needs in sea-going, aviation, and other occupations. Despite their importance to solving recruiting and retention problems, and substantial increases in special pays and bonuses in recent years, spending on these pays in 1982 will still only amount to around \$1.5 billion, or about 4 percent of total military pay and allowances. The Administration has recommended some increases in funding for these special pays and bonuses, but more could probably be added. As an important corollary step, the Congress could increase the maximum allowable size of the bonuses, particularly the enlistment bonus. The maximum enlistment bonus was raised to \$5,000 last year. In recent testimony, the Acting Assistant Secretary of Defense for Manpower, Reserve Affairs, and Logistics asked that the ceiling be increased to \$10,000 starting in 1982.

Use of special pays and bonuses rather than across-the-board pay raises could cut costs. We have not estimated exact savings. But let me illustrate the possibilities for bonuses with some estimates from a study done earlier this year for the House Budget Committee. That study estimated added costs to continue improvements in retention and to meet recruiting goals, including the test-score constraints and the goal of having 65 percent of all

Army recruits hold high school degrees. Over the next five years, added costs (in today's dollars) ranged from \$5 billion with targeted bonuses to \$22 billion using across-the-board pay increases. Thus, bonuses were more than four times cheaper in meeting recruiting goals.

As an alternative to higher special pays and bonuses, or perhaps along with them, the Congress could target any extra pay raises more selectively. This could be done by expanding the pay-raise "reallocation" authority that now exists and by urging or even requiring that the Administration use this authority. Existing authority allows the President to reallocate as much as 25 percent of each military pay raise differentially according to pay-grade and years of service. This authority could be applied to the 5.3 percent raise and/or subsequent raises. It could be used, for example, to provide larger raises for some junior enlisted careerists but lower raises for more senior careerists and officers.

The reallocation authority has some drawbacks, however. The services have been reluctant to use it, perhaps because of the difficulty of deciding who should get more and who less. The authority does not apply to those with differing skills, and thus lacks the flexibility of reenlistment bonuses, which can be targeted on specific occupations. Finally, current law prohibits use of reallocation to increase pay raises for those with four or

fewer years of service. If the Administration is to use the reallocation authority to help meet recruiting problems, the Congress might consider eliminating that prohibition.

Targeting increases in pay might be especially important if the United States substantially increases the size of its military forces. The added money to attract and retain persons needed under a larger force will be expensive even if targeted increases are used. But it will be extraordinarily expensive if it is done by using across-the-board pay raises. Such cost increases might require reconsideration of the all-volunteer system.

We don't want to leave the Task Force with the impression that targeted increases in pay are a panacea. It is probably desirable to use them only in conjunction with across-the-board pay raises that maintain general pay levels. Also, overuse of targeted increases could create problems among more senior persons who do not receive bonuses. Nonetheless, as we mentioned, special pays and bonuses today comprise only about 4 percent of total pay, which suggests they could be increased without creating major imbalances.

Increased Education Benefits

In 1977, the Congress replaced the Vietnam-era G.I. Bill with a voluntary program that requires those who participate to contribute up to \$100 a month of their pay; the government then

matches these contributions on at least a two-for-one basis when the person withdraws the money to attend school. Perhaps because of the required contribution, the program has not been popular with enlistees. Only about one-quarter of new military recruits have signed up. Also, there is evidence that the program has done little to improve recruiting.

Improving military education benefits, however, is popular with the Congress. To date, eight bills to provide some form of a new G.I. Bill have been introduced in the 97th Congress.

Improved military education benefits could help recruiting, particularly of high school graduates with high test scores, since surveys show they are the most likely to want to continue their education or training. Education benefits might also enhance the image of the military as a desirable place to serve before continuing in school.

On the other hand, more generous education benefits might be relatively ineffective as a recruiting incentive. Youths today can use numerous federal and state student aid programs that do not require military service. Also, the desire to continue in school may be less strong among those who enlist in the combat arms. For these reasons, even a generous package of military education benefits may not significantly aid recruiting, particularly for skill areas like the combat arms where recruiting shortages are most severe. In addition, under most

proposed plans, significant use of education benefits is delayed for several years until a person completes military service. Since young persons generally have a strong preference for receiving benefits now rather than later, the education benefits needed to meet recruiting goals might have to be more generous--and hence more expensive--than the enlistment bonuses needed to accomplish the same goals.

CBO is currently developing estimates of the costs and recruiting effects of alternative versions of a new G.I. Bill. At this point, we do not have any overall assessments to offer the Task Force about their effects on recruiting and retention. When fully implemented, however, the programs being considered are likely to add around \$1 billion a year (in today's dollars) to the military budget. One point seems clear. The costs of meeting recruiting goals with education benefits will be substantially higher if benefits are made available to all new enlistees, as was the case under the old G.I. Bill, rather than being targeted at those groups of recruits in short supply. Thus, in considering education benefits, the Congress faces a choice between targeted benefits and higher costs that is similar to the one discussed above with regard to enlistment bonuses and across-the-board pay raises.

Further Restructuring of Military Retirement Pay

The military retirement system is both an important influence on retention and an important part of manpower costs. Under the current system, all nondisability retirees who leave active duty with 20 or more years of service receive immediate, life-long benefits that are adjusted for CPI increases. Persons who leave the service without disability and with fewer than 20 years of service receive no benefits. Since retirees often leave the service in their 40s and receive benefits for many years, military retirement is expensive; its costs will amount to \$15.4 billion in fiscal year 1982. The retirement system also heavily influences retention, particularly of those with close to 20 years of service.

Five major studies, done over the last 10 to 15 years, have all recommended changes in retirement benefits. Changes would be designed to improve the pattern of retention. All studies recommended making the system more generous by providing some benefits for those who leave with between 10 and 19 years of service. This "early vesting" of benefits would enable retirement benefits to provide a stronger lure at the first reenlistment point. In addition, all five studies recommended reducing benefits for some who leave with exactly 20 years of service, though the amount and nature of the recommended reduction varied widely. In 1980, the Congress moved in the direction of making

benefits less generous by requiring that retirement pay for new recruits be based on the three years when their pay was highest, rather than their pay on the day of retirement.

The Congress could continue to change the military retirement laws along lines recommended in various studies. As part of a recent report on budget reductions, CBO illustrated one possible change. It would implement a Social Security "offset" for non-disability retirees to reflect military participation in the Social Security System. The offset would reduce annuities for those receiving Social Security by the portion of the Social Security pension attributable to military service, but not by more than 40 percent of military retirement benefits. This formula was enacted last year for the military survivor benefits program. Using some of the savings from this offset, the Congress could also provide a deferred benefit, beginning at age 60, for those leaving the military with between 10 and 19 years of service. This deferred benefit would be based on the same formula as the annuities provided those serving longer careers.

The deferred benefit for those serving 10 to 19 years should increase the rate of reenlistments by first-term personnel. This should offset the decline in retention among more senior personnel resulting from the Social Security offset. This package would thus increase the numbers of career personnel with five to 12 years of service, a shift which may be desirable.

These two changes could also save money. Savings in the active-duty retirement system would eventually reach \$0.9 billion a year in today's dollars. (Analogous changes in reserve retirement would add another \$0.3 billion a year.) Savings, however, would not begin for at least 20 years, until those retiring today were eligible for Social Security benefits. Savings would be delayed even longer if the Congress chose to exempt from the changes some or all of those now serving on active duty.

The long delay before any savings are achieved has made changes in the retirement system difficult to enact. This problem suggests the importance of implementing "accrual" accounting for military retirement. Implementing accrual accounting would not affect retirement benefits. But it would change the military budget to reflect the liabilities that are building up because of today's retirees; currently the budget reflects only the costs of those already retired. If accrual accounting were implemented, then the long-run savings from changes in the retirement system would show up immediately in the military budget. The Reagan Administration apparently will support the accrual accounting changes proposed by the Carter Administration. The House Budget Committee, which would have to approve the accounting changes, could have an important effect on future debates of military retirement reform by supporting enactment of the accounting changes.

The delay in savings is, of course, not the only objection to changes in military retirement benefits. The services would probably oppose the changes as an erosion of benefits, particularly if they applied to anyone now on active duty. Also, the estimates of effects on retention are uncertain, and there could be some adverse effects. Perhaps for these reasons, the new Administration apparently will not recommend any changes in military retirement, though far-reaching changes were proposed by the Carter Administration. Nonetheless, in a period when the Administration is trying to improve military retention while also holding down government costs, restructuring of retirement pay--included as part of a package of increases in military compensation--may deserve consideration by this Task Force and the Congress.

COMPARISONS OF MILITARY AND CIVILIAN PAY

CBO's analysis has focused on the effects of military compensation policies on recruiting and retention. We believe that these are the most helpful measures we can provide. They reflect the effects not only of changes in pay, but also of changes in demand for careerists and recruits as well as the effects of non-pay personnel policies.

The Task Force also requested, however, some comparisons of military and civilian pay. Such comparisons are fraught with

problems. It is difficult to define civilian jobs that are comparable to those in the military, particularly in view of some of the special dangers and rigors of military service. It is also difficult to equate military pay--which includes a wide range of cash and in-kind benefits--with civilian pay that may feature more cash but fewer benefits. The timing of military pay also makes comparisons difficult. Relative to civilian pay systems, military compensation contains more deferred benefits--principally from the retirement system--and less pay during active service.

Despite these major problems, comparisons of military and civilian pay may provide a rough guide to the competitiveness of military pay levels. For purposes of comparison with enlisted personnel, civilian salaries for workers holding high school degrees were taken from the March 1978 Current Population Survey and adjusted to expected 1982 levels using a wage index. Results were then compared to military "salaries" (including basic pay, major allowances, and the tax advantage that accrues because the major allowances are exempt from federal income taxes) for enlisted personnel at similar ages. The comparison showed that, after the pay raises proposed by the Reagan Administration through fiscal year 1982, enlisted personnel would be close to the median pay levels for civilian craft and kindred workers. This suggests that the military may be competitive, at least with median pay for major types of work in the private sector.

In addition, the amount of the "spread" in military pay has increased in recent years, thus making it easier to compete for persons with technical skills. For example, a typical Navy enlisted person with five years of service would earn a basic equivalent salary of about \$16,000 after the pay increases recommended by the Administration. For sea duty, he could earn another \$2,000 in sea pay. In a housing area like the one in Norfolk, the variable housing allowance could add roughly another \$1,000 to his annual earnings. And, in certain highly technical skills--like nuclear propulsion--he could be benefiting from a reenlistment bonus of as much as \$20,000, or about \$5,000 a year if he reenlisted for four years. Thus, his total cash pay could equal about \$23,000 a year. In addition, he would be eligible for health and other fringe benefits, the largest of which is military retirement. The DoD actuary estimates that, for the average person, military retirement is equivalent in value to about 50 percent of basic pay. By that reckoning, retirement benefits--while not available on active duty--are worth about \$5,000 a year to a Navy petty officer with five years of service.

COMPENSATION ALTERNATIVES AND THE ALL-VOLUNTEER MILITARY

We would like to conclude by reiterating the three key points of our testimony. First, the major changes in pay enacted by the last Congress will probably increase numbers of career

personnel. But some services--particularly the Army--are still likely to have major problems attracting enough high-quality recruits. The Reagan Administration has proposed further increases in pay--principally in the form of an across-the-board pay raise of 5.3 percent in July--that are likely to improve retention further and allow the services to come close to meeting 1982 recruiting goals. The Congress, and perhaps the new Administration, may also want to consider some alternative compensation changes that could improve recruiting and retention while holding down costs. Included might be more use of targeted increases in pay, some form of a new G.I. Bill, and further restructuring of military retirement pay.

Mr. Chairman, the added costs of maintaining an all-volunteer military force over the next several years will be substantial under any circumstances. Our testimony suggests, however, that the amount of the increase varies widely depending on whether recruiting and retention goals are met by providing raises to all personnel or by a gradual restructuring of the military pay system, perhaps employing some of the alternatives we have discussed today. Costs will undoubtedly play a role in assessing the viability of the all-volunteer military. Thus the pay decisions that the Administration and the Congress make in the next few years may be an important factor in the success or failure of the all-volunteer force.